

MEMORANDUM

To: Chairman Senator Drew Perkins
Vice Chairman Representative Bob Nicholas
Members of the Select Committee on Capital Financing and Investments
From: David Swindell, Executive Director, Wyoming Retirement System (WRS)
Date: September 22, 2022
Re: WRS Performance Compensation Update

1. Performance Compensation was earned and approved for the period ending June 30, 2022.

We are pleased to report that the investment team has outperformed the portfolio benchmark by 1.58% annualized for the trailing three-year period ending June 30, 2022. As a result, the team is eligible to earn its collective maximum bonus of \$768.6 thousand. This amount represents only 0.17% of the total three-year value-add. Only \$192 thousand (0.04%) will be paid out in the first year as a result of vesting. This result demonstrates how the performance compensation plan provides WRS with an effective mechanism to provide the investment staff with more competitive compensation, but only in the case of superior performance. I will also note that the team was able to achieve these excess returns while maintaining a superior risk-adjusted return than the benchmark (Sharpe ratio of 0.8 vs. 0.66).

Highlights of performance include:

- Value added over the benchmark:
 - 1-Year: \$148 million
 - 2-Year: \$253 million
 - **3-Year: \$444 million**
- The portfolio performed extremely well relative to benchmark over the past year, during a period in which global stocks fell approximately 16%.

Annualized Net Performance % as of June 30, 2022

	<u>QTD</u>	<u>2022 YTD</u>	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>5 Years</u>	<u>7 Years</u>	<u>10 Years</u>
WRS Total Portfolio	-6.62	-8.36	-2.76	11.26	8.24	7.74	7.20	7.88
Strategic Benchmark	<u>-6.85</u>	<u>-9.20</u>	<u>-4.63</u>	<u>9.50</u>	<u>6.66</u>	<u>6.54</u>	<u>6.31</u>	<u>7.16</u>
WRS Outperformance	0.23	0.84	1.87	1.76	1.58	1.20	0.89	0.72
Peer Rank (Percentile, lower is better)	19	19	11	10	9	16	20	45
Benchmark Peer Rank	26	27	29	40	37	51	54	73

We also note the strong peer performance over multiple time periods. Over the past seven years, the investment results have been in the top quintile (top 20%) and over the past three years, the results have ranked in the top decile (top 10%).

These results were achieved without excessive risk.

- As noted below, the WRS Sharpe ratio (risk-adjusted return) has been in the top 15th percentile for every period over the past five years. The Sharpe ratio is a commonly used industry measure of the incremental return of a portfolio per unit of risk. The formula is: (portfolio return minus risk-free rate)/standard deviation of returns.
- The portfolio Sharpe ratio has been higher than the benchmark for every period.
- The WRS benchmark has been in the top quartile of the peer set over the past three years, and in approximately the top third for the other periods. This indicates that the WRS benchmark performed better than the median peer and is not easy to outperform.

Risk-Adjusted Return (Sharpe Ratio) as of June 30, 2022				
	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>5 Years</u>
WRS Total Portfolio	-0.38	1.35	0.80	0.78
Strategic Benchmark	<u>-0.67</u>	<u>1.17</u>	<u>0.67</u>	<u>0.66</u>
WRS Over/Under	0.29	0.18	0.13	0.12
Peer Rank (Percentile, lower is better)	11	11	14	15
Benchmark Peer Rank	34	23	25	37

2. Process and Calculation Review and Confirmation

WRS performed a number of overlapping steps to ensure that the performance compensation calculation is correct, including:

- **The investment team** verified all inputs, with numerous third-party verifications as noted below.
- **WRS Internal Accounting** verified the inputs, and the accuracy of the calculation methodology and results. They also compared the performance calculated by Meketa and our custodian Northern Trust and found them to be comparable.
- **WRS Internal Audit Department** conducted a review for the Audit and Risk Committee. They concluded, “IAD has reviewed and compared the 2020, 2021 and 2022 WRS Annual Performance Compensation processes and has not identified any changes which would significantly increase or decrease the risk in the WRS Investment Team’s process. Although risk cannot ever be completely eliminated, WRS’s process appears to have an acceptable amount of risk and is in compliance. IAD recommends approval of the 2022 WRS Annual Performance Compensation as proposed.”
- The Board’s **independent investment consultant Meketa Investment Group** reviewed the inputs, calculation methodology and accuracy. They concluded, “Meketa has reviewed the inputs and the calculation, as well as the legislation authorizing the Incentive Compensation, and concurs with WRS’ calculation. Following our review of the available data, it appears that Staff is eligible for 100% of their incentive compensation for the year ended June 30, 2022 based on three-year performance. It

further appears that WRS has appropriately utilized the statute to calculate the incentive compensation that the investment staff are eligible for.”

3. Staffing.

There was no investment staff turnover during the past year. Eventually, we will experience some. However the performance compensation program does appear to be contributing towards keeping turnover lower.

4. Base Salaries.

As the committee is well aware, the performance compensation is ultimately a percentage of base compensation. Base compensation is limited by the budget footnotes.

The current budget footnote states:

1. Beginning July 1, 2022 and ending June 30, 2024, except for performance compensation authorized under W.S. 9-3-406(a), no funds shall be expended to increase the compensation of Wyoming retirement system investment employees listed in W.S. 9-3-406(a)(ii) without executive authorization and legislative action.

This footnote keeps in force salaries adopted in HB001, HEA No. 51, 65th legislature, 2019 General Session:

1. (a) For the period beginning on the effective date of this act and ending June 30, 2020, the maximum annual salary to be paid for each investment staff position classification, as determined by the retirement board of the Wyoming retirement system, shall be as follows:

- (i) Two hundred fifty thousand dollars (\$250,000.00) for the chief investment officer;
- (ii) One hundred eighty-nine thousand dollars (\$189,000.00) for a senior investment officer;
- iii) One hundred thirty-two thousand dollars (\$132,000.00) for an investment officer;
- (iv) Ninety-three thousand dollars (\$93,000.00) for a senior analyst;
- (v) Seventy thousand dollars (\$70,000.00) for an analyst.

These base amounts are challenged by inflation and market competition.

Inflation:

- Inflation from July 2019 to August 2022 = 15.4% (CPI-U)
- 10 months Inflation from September 2022 to July 2023 will surely add at least 5% (annual rate right now is above 8%), implying an inflationary adjustment of 20% or more.

Market competition:

October, 2021 McLagan Survey

- 61 Funds (including AZ, CO, ID, IA, KS, MT, NE, NM, SD, UT, among others)
- 43% offered incentives like performance compensation, often with larger amounts, less vesting, etc.

- WRS CIO base was -26.8% lower than median
- WRS SIO base was -17.7% lower than median
- Endowments and Foundations have base salaries that are roughly 2x public pensions

Anecdotally, we're aware that the analyst range for the Montana Board of Investments was recently advertised as \$80,000 min to \$100,000 max, for qualifications similar to (and arguably less) than our junior analysts. We typically pay new analysts approximately \$55,000 to \$60,000, with a max amount of \$75,000.

Some adjustment to base wages is indicated. Those adjustments should be coordinated with Treasury to avoid excessive inter-agency talent competition. There might be some other adjustments to performance compensation percentages, vesting periods and such that might make sense, although overall the existing program has been instrumental in our success over the past several years. There are some non-performance compensation issues like moving allowances for out of state hires that are worth discussing as well.